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SUBJECT: RUSSIA: AMBASSADOR'S MEETING WITH ANATOLIY CHUBAYS

Classified By: Ambassador William J. Burns for reasons 1.4 (b/d)

¶1. (C) Summary: In a September 19 meeting with the Ambassador, UES CEO Chubays was very upbeat about UES reform and the liberalization of electricity prices. He confidently predicted that strategic investors and IPOs in London and Moscow would raise the investment UES needs to meet its five year target. While clearly distraught about the Kozlov assassination, Chubays nonetheless was cautiously optimistic that banking reform would continue. End Summary.

PASAT CASE  
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¶2. (C) Chubays thanked the Ambassador for USG assistance on the Pasat case. (the former Moldovan Defense Minister who was charged with embezzlement involving the sale of Mig-29s to the U.S.). Chubays had learned that U.S. authorities assisted by providing affidavits in the case.

KOZLOV ASSASSINATION  
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¶3. (C) Chubays expressed doubt that the perpetrators of deputy Central Bank chair Kozlov's murder would ever be found. Nonetheless, he had spoken with the Central Bank chair Sergey Ignatiev, and he was cautiously optimistic that Kozlov's murder would not slow down the Central Bank's efforts to increase supervision over the banking system. Chubays agreed that Kozlov would be difficult to replace because of his knowledge, experience, and reputation.

UES REFORMS

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¶4. (C) On UES reform, Chubays boasted that no one had thought it would be possible to accomplish market liberalization and private investment in the electricity sector. Without Putin's support, the reforms would be impossible. No one expected such difficult decisions, such as the liberalization of electricity prices, could be made so close to the elections. He described the Russian model as the &best (designed) market in the world because it included no price caps, and the best software and legal foundation.

¶5. (C) Chubays said his road show through Western capitals

had been a success and UES would have no problem getting investors to fulfill its 5-year investment target of \$81 billion. He predicted that IPOs planned for next year in Moscow and London would raise up to \$17.5 billion. The real test will be the upcoming winter. Last winter consumption unexpectedly grew by 5 percent instead of 2 percent. He is expecting to impose usage restrictions in 16 regions (in contrast to 3 regions last year). Chubays admitted, given expected shortages, reform could actually pose some risks, but market signals, by differentiating between peak and non-peak hours, would create a powerful instrument for the industry.

#### ELECTION CYCLE POLICIES INSTEAD OF REFORMS

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¶16. (C) On the economy, Chubays said that he did not support many of the policies being enacted. Referring to the state's growing footprint in the energy and automobile sectors, he cited Gazprom, Gazprombank, and Avtovaz as examples of policies that he could not support. Avtovaz was a mistake and it would soon be obvious. He predicted that the government would realize its mistake and reverse its decisions after a few years. Chubays expressed his frustration that nothing was happening with reforms in the pension, health, education, and housing sectors, as Russia was entering into another political cycle. It would be difficult to do anything until after the elections.

#### POLITICAL LANDSCAPE

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¶17. (C) When asked about the merger of Federation Council Speaker Mironov's Party of Life, Rodina, and Party of Pensioners, Chubays said that while not a fan of Mironov, the merger of the parties on the left was &pragmatic8 and &reasonable8 because it increased the chance that the

combined party will make the 7 percent cutoff for seats in the Duma. The current consolidation of parties reminded him of a similar tactic during the Yeltsin years. Rodina was very dangerous, but under Mironov (even with all his faults) Rodina could become &civilized.8 Chubays repeated the refrain that the parties on the right have to unite (to become a viable political force).

¶18. (C) About the outcome of the presidential elections, Chubays remarked that &it is determined. Whoever Putin chooses to be the candidate will win.8 The &traditional way8 would be to select a successor no earlier than one to one and a half years prior to the elections and install them as the Prime Minister. In that scenario, whoever holds the Prime Minister position at the end of 2006 might well become the next president.

#### U.S.-RUSSIA RELATIONS

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¶19. (C) When asked about the current state of U.S.-Russia relations, Chubays spoke in broad terms about the post 9-11 missed opportunity when international support was strong. He warned that anti-American sentiment is growing in Russia and U.S. moral authority, which is a key component of the relationship, is slipping. Those who criticize the U.S. argue that rhetoric on democracy building and actions in Iraq do not coincide. These arguments are resonating with the population and could bring U.S. critics to power. Chubays cited Vice President Cheney's speech in Lithuania as an example of what negatively affects our relationship. Chubays agreed with the Ambassador that there was nothing new in the speech, but repeated that it was a mistake, and claimed that such rhetoric is counter productive.

¶10. (C) On economic relations, Chubays said he was very upset when the WTO bilateral talks during the July G-8 meetings did not result in an agreement on Russian accession.

He had an emotional talk with Economic Minister Gref lamenting the failure to close the deal. He emphasized that both sides needed to find the political will to conclude negotiations. Further delay would seriously undermine the relationship, handicap the process of economic modernization in Russia, and play into the hands of the domestic opponents of modernization.

COMMENT

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¶11. (C) UES restructuring is one of a small handful of positive developments in Putin's second term reform agenda, but progress will come with its own challenges and opportunities. As Chubays himself acknowledged, price liberalization is fraught with political risks, but, the Kremlin's attention to politically sensitive issues like inflation will probably mean that any increases will happen gradually. The Kremlin's role in the selection of strategic investors for UES assets will also be a key indicator to follow. Kozlov's death has made a strong impact on Chubays; he was clearly distraught at Kozlov's wake.

BURNS